

## **ECF Best Practices Open Forum Notes**

**November 14, 2008**

**Lincoln, Nebraska**

### **Chapter 7 Bankruptcy Best Practices**

#### **Means Test and Creditor Abuse**

**Jerry Jensen, UST**

#### **1. Purpose of the Chapter 7 Best Practices Forum.**

Jerry Jensen of the U.S. Trustee's office will update you on the most recent cases regarding means testing issues and the most common errors in completing the means test form. Jerry will also discuss the U.S. Trustee Program's newest initiative to address abuse by creditors in bankruptcy proceedings.

#### **2. National Guard and Reservists Debt Relief Act.**

a. On October 20, 2008, the President signed into law S. 3197, the National Guard and Reservists Deb Relief Act of 2008, Pub. L. No. 110-438. This new law will be effective December 19, 2008. It exempts from the means test, for a limited period, qualifying reservists and National Guard debtors who are called to active duty or to perform a homeland defense activity for not less than 90 days. A debtor may only claim the exemption if his/her case is filed while on active duty or within the 540 day period immediately following the conclusion of active duty. The new exemption is temporary and will apply only to cases commenced during the three years after December 19, 2008.

b. The Advisory Committee on Bankruptcy Rules is preparing revisions to Interim Rule 1007 and Form B22A to permit debtors to claim the exemption.

c. Form B23 will be revised to include a check box for this exemption.

#### **3. Primarily Consumer Debts.**

a. Remember Form B22A - Means Test Form is only required if debts are "primarily" consumer debts.

b. But note - Form B22C is required in Chapter 13 cases regardless of nature of debt.

c. Nebraska Bankruptcy Court had adopted position that debts are primarily consumer debts if more than ½ of the dollar amount owed is consumer. Stephen & Jennifer Lapke, Case No. 07-81140.

d. Nebraska Bankruptcy Court held that it will not allow debtors to disregard

representations that debt was consumer in nature and reclassify it as a business debt to avoid need to repay creditors. Linda Coppi, Case No. 07-82544. For example, you can't tell a lender that it is a consumer loan and then state on the Means Test that it is business debt.

#### **4. Common Errors in Completion of Form B22A**

- a. Use of Outdated Data
- b. The Census Bureau's median family income data accessible through the "Means Testing Information" page, has been updated on UST website [www.usdoj.gov/ust](http://www.usdoj.gov/ust). The U.S. Trustee Program will apply the updated data to all cases filed on or after October 1, 2008.
- c. The IRS's National Standards for Allowable Living Expenses and Local Standards for Transportation and Housing and Utilities Expenses accessible through the "Means Testing Information" page, has been updated on UST website [www.usdoj.gov/ust](http://www.usdoj.gov/ust). The revised standards apply to cases filed on or after March 17, 2008.

#### **5. Income Issues**

- a. Most common error continues to be Calculation of "Current Monthly Income." Income is determined by what pay advices state. That is the income amount that should be listed on the Means Test Form. This amount should also match the amount listed on Schedule I.
- b. Six Months Income- Historical Figures
- c. Any amount contributed to the debtor's household expenses by another entity on a regular basis. Section 101(10A)(B)
- d. Looks back six months (ending with the last day of the month before the month of filing). 101(10A)
- e. UST may request entire six months of pay advices.
- f. Jerry wanted to make it clear that when filling out the Means Test Form, debtors must include income for ALL contributors in the household expenses even if the contributor is not a spouse of the debtor. If the debtor is paid anything for monthly expenses by roommates, adult children etc. this must be listed.
- g. You do not include tax refunds or loan payments on the means test.
- h. Jerry will file a Presumption of Abuse, if applicable, within 10 days of the 341 hearing.
- i. "Catch All" Income - Line 10

j. Includes gambling winnings, cash gifts, (not otherwise regular contributions) litigation proceeds, trust income, etc.

k. Includes veteran's disability and other non-SSI disability payments.

l. Does not include SSA benefits (retirement, survivors, disability, SSI)

m. Does not include tax refunds

n. Does not include loan proceeds.

o. Line 10 - 401(k) distributions

p. Should "Distributions" from 401(k) plan during the CMI period be reflected as income? They should not be included on the Means Test.

q. Nebraska Bankruptcy court has ruled that such distributions are not included in CMI. David D. Marti, Case No. 07-41827.

**Question:** If a family is giving the debtor regular loans is it considered income?

**Answer:** It is not considered income but if it is not a loan, it is income and needs to be listed.

**Question:** Can debtor give UST more information regarding previous pay prior to abuse being filed?

**Answer:** No. Debtor doesn't need to give that information until the 707 is filed.

## **7. Income Issues Cont'd**

a. Applicable Median Family Income  
- Bankruptcy Code elected not to define this.

b. Line 14 - continued

c. "Household size" generally includes the debtor, spouse (but not if box 2b is checked) and any dependents as defined by IRS. This application takes into consideration both the census bureau's family income figures and the IRS national expense standards.

d. There may be reasonable exceptions.

e. "Dependent" is "qualifying child" or "qualifying relative"

f. See IRS Publication 501 (Exemptions, Standard Deduction and Filing Information)

g. Line 14 - non-dependents

h. Where a debtor includes a non-dependent individual in his/her household size, all income earned by the non-dependent should be included in the debtor's CMI calculations.

i. If not all is contributed, UST may request documentation to verify.

- UST says there has not been a determination on "household size." Trustee is pretty flexible on this issue. If debtor includes someone that is not a debtor or a child, UST may ask for that persons' income information.

**Question:** How do you handle adult children temporarily living with the debtor/parent and the debtor/parent is supporting them?

**Answer:** Jerry would look at it but it probably won't be an issue. Jerry recommends calling him if you aren't sure.

**Question:** As it relates to non-family members contributing to expenses, how do you want that listed?

**Answer:** Just show what the non-family member contributes by including their income and deducting out their expenses. If this is the case, Jerry wants to see the non-family members pay advices too.

## **8. Income Issues - Marital Deduction**

a. Calculation of CMI for 707(b)(2)

b. Lines 16 - 18

c. General Rule is ALL income of non-debtor spouse is included in calculation.

d. However, some expenses of non-debtor spouse may be "adjusted" or "backed out"

e. Should not "back out" amounts if they are claimed as expenses elsewhere on the form.

f. Debtor and non-debtor spouse would have to be living in the same household.

g. "Adjust" for expenses which do not contribute to debtor's household's "bottom line" which may include:

- Prior domestic support obligations on non-debtor spouse
- Student loan payments for non-debtor spouse
- Withholding taxes for non-debtor spouse
- Debt payments on which ONLY non-debtor spouse is liable (but may be considered a "contribution" on line 8)
- 401k contributions/loan repayments for non-debtor spouse

h. Taxes withheld from income - Debtor can claim only the actual tax liability rather than the full withholding amount.

- Jerry says he finds a lot of disposable income on this. Debtor needs to put what his/her REAL tax liability not what is being withheld. There may be more money available due to what is being withheld than what the real tax liability is.

- Jerry also says that when one spouse files and the other doesn't, it makes things difficult. Debtors must remember that the non-filing spouse must report their income on the means test as well.

- And, as it relates to health care, Line 19b allows standard deduction but don't "double dip." Line 31 list only amount above what the health care standards are. If out of health care expense account than it doesn't come "out of pocket."

**Question:** Is Railroad Retirement excluded like SSI?

**Answer:** It is not a payment under SSI Act so it would need to be included.

**Question:** What if it is not disclosed?

**Answer:** Trustee may not catch it. You would put it on Statement of Affairs, Schedule I and Schedule J so the Trustee would probably catch it there.

**Question:** May Debtors who intend to surrender collateral take a secured debt deduction?

**Answer:** The debtor is entitled to deduct the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition. 707(b)(2)(A)(iii)(I).

**Question:** What if taxes in 2007 are extremely higher / lower than they will be in future years?

**Answer:** Trustee will take that into account and they will realize that may be the case.

## **9. Judicial Approaches to Surrender**

- Debtor may:

- a. Deduct all scheduled secured debts regardless of intention to surrender.
- b. Deduct all scheduled secured debts if collateral has not been surrendered as of the hearing on the 707(b)(2) motion, or
- c. Not deduct scheduled secured debts if debtor intends to surrender
- d. IRS standards can include internet services

- UST says that there is no separate deduction for cell phones. Example, Line 32 on the means test was already received that deduction on Line 28.

### **- Nebraska Bankruptcy Court's Position**

**- Secured debt payment allowed for surrendered property in Chapter 7, but not Chapter 13**

- Brandi Vandenberg, Case No. 07-82291 (Chapter 7) - Court noted that intent to surrender however may be considered under 707(b)(3).

- Jeffrey & Vivian Fager, Case No. 07-81411 (Chapter 13)

**Question:** May debtors with paid-off Cars/Homes take the IRS “ownership” deduction?

**Answer:** The debtor is allowed to deduct the debtor’s applicable monthly expense amounts specified under the Local Standards. 707(b)(2)(A)(ii)(I).

Jerry says this issue has been litigated in many Bankruptcy Courts. See below:

- a. No-deduction courts say such debtors have no “applicable” ownership expense.
- b. Deduction courts say such debtors are allowed the amount “specified” in the Standards; the Standards are “allowances” and are not tied to actual expenses.
- c. 8<sup>th</sup> Circuit BAP has ruled that not automobile ownership expense allowed if debtor has not debt. Wilson v. Babin, 383 B.R. 729.
- d. UST Program’s position is that an additional \$200 operating expense if older vehicle/high mileage. The vehicle would need to be at least six years or older and have 75,000 miles or more in order to be able to have this deduction. The car also needs to be paid off to claim this deduction.

UST says if you are surrendering the property, no deduction is allowed on Line 42. Nebraska BK Court states that in Ch. 7 cases, you may still deduct that payment on the means test form because that’s what the statute states. You cannot deduct that in a Ch. 13 case.

**10. Debtor with no Mortgage or Rent**

a. Nebraska Bankruptcy Court has disallowed mortgage or rent expense for debtor who does not pay either mortgage or rent and has no “applicable” expense. John Swanson, Case No. 08-81388.

- The issue that arose in this case was that debtor failed to disclose that he was living with his girlfriend and she was paying all of the bills. Debtor tried to use the deduction but he was not allowed the deduction.

b. Court based ruling on 8<sup>th</sup> Circuit BAP’s decision in Wilson which held that debtor must have applicable IRS expense in order to claim deduction.

**Question:** The standard is at the time of filing, correct?

**Answer:** Yes but it is hard to determine. Jerry is not sure why they look back for income and look forward for expenses.

**11. Special Circumstances (Section 707(b)(2)(B))**

- Jerry needs to have evidence from the debtor(s) as to why there are special circumstances. For example, affidavits.

**Question:** Is there an overboard on evidence that is provided to the UST?

**Answer:** For example if UST needed utility bill receipts, they would need more than a month but not 12 months.

a. In re Batzkiel, 349 B.R. 581 (Bankr. N.D. Iowa 2006) (Special Circumstances: additional expenses from lengthy commute and due to repeated deer / auto collisions).

b. Any legitimate expense that is out of the ordinary  
- for an average family or that may have increased since the IRS guidelines were calculated, could be considered as a special circumstance. Batzkiel, 349 B.R. at 586, quoting 6 Collier on Bankruptcy T[707.05[2][d]

c. In re Sparks, 360 B.R. 224 (Bankr. E.D. Tex. 2006) (Special Circumstances)

d. Additional rent (single debtor rented a 3 bedroom apartment) and transportation expenses not “special circumstances.”

e. Serious medical condition and call to active duty in military depict the type of unanticipated development which leaves a debtor with no reasonable alternative but to incur the expense or accept the income adjustment. Special circumstances are certainly not demonstrated merely by showing that the Debtor has incurred these expenses in the past. The exception to the parameters of acceptable expenses must be strictly construed to allow only those expenses which are truly unavoidable to the debtor.

## **12. Special Circumstances - Student Loans**

a. Nebraska Bankruptcy Court has ruled that non-dischargeable student loan debt does not, standing alone, constitute special circumstances to rebut the presumption of abuse. Ronald & Betty Wagner, Case No. 07-42262.

- Jerry says that this is very hard to show and a limited argument.

## **13. Special Circumstances - 401K Loan Payments**

a. 401k loan payments are not secured debts. Don & Margaret Herbert, Case No. 07-40224.

b. 401k loan payments are not allowed as a deduction on Ch. 7 means test form but the mandatory nature of the repayment of a 401k loan may be a factor to be considered as a special circumstance. Robin & Danette Samson, Case No. 08-80615.

- Jerry says that while the 401k loan payment is not a secured debt and cannot be a

deduction on a Ch. 7, it can be on a Ch. 13.

c. If court allows 401k loan payment as a special circumstance, balance of 401k loan obligation should be divided over period of 60 months. LaDonna Novak, Case No. 07-81554.

d. 8<sup>th</sup> Circuit BAP agreed with Novak decision. Coop v. Lasowski, 384 B.R. 205.

#### **14. Other Nebraska Decisions Regarding Special Circumstances**

**- Billy & Heather Starkey, BK06-81473, Ch. 7**

- Debtors may not deduct excess housing costs in means test, and living in an expensive area does not constitute a “special circumstance” to rebut presumed abuse.

**- Don & Margret Herbert, BK07-40224, Ch. 7**

- Reduced OT pay isn’t “special circumstance.”

**- Kevin & Kathy Ryder, Case No. 07-40538**

- Voluntarily quitting second job did not rise to the level of special circumstance.

**- Mary Ferando, BK06-81855, Ch. 7**

- The Court rejected debtor’s argument that her commissions earned in the previous six months were unusually high & constituted “special circumstances” to rebut the presumed abuse.

#### **SECTION 707(b)(3)**

- 707(b)(3) applies where the presumption of abuse either does not arise or is rebutted.

- Court “shall consider” whether:

1. The debtor filed the petition in bad faith (Section 707(b)(3)(A); or
2. The totality of the circumstances of the debtor’s financial situation demonstrates abuse.

- Jerry reminds everyone that just because you “pass” the means test does not mean you are able to stay in a Ch. 7.

#### **15. Passing the Means Test Does Not Preclude Motion Under (b)(3)**

a. Hon. Eugene Wedoff, Means Testing in the New 7807(b), 79 Am. Bankr. L.J. 231 (2005).

b. Legislative History (2000 Legislation)

c. Nebraska Bankruptcy Court has agreed that passing the means test does not preclude

dismissal under 707(b)(3).

### **NEBRASKA 707(b)(3) CASES**

#### **- Ryan Gannon, BK06-41399, Ch. 7**

- U.S. Trustee's motion to dismiss under section 707(b)(3) is granted because debtor appears able to make substantial payments to creditors through a Ch. 13 Plan. Debtor's annual bonus should be included in income because he has received it each year.

- Debtor received a bonus for at least five years and so it was determined that he had the ability to pay creditors even though he "passed" the means test.

#### **- Brenda Nissen & Gregory Mahar, Ch. 7, BK07-80605-TLS, BK07-80606-TJM**

\_\_\_\_\_ - Under 11 U.S.C. sections 707(b)(1) and (3)(b) it is an abuse of Ch. 7 to permit debtors to devote more than 82 percent of their income to interest-only mortgage payments for a brand new residence while paying nothing to their unsecured creditors.

#### **- Stephen & Jennifer Lapke, Case No. 07-81140**

- Court state there is no "bright line" rule as to whether a debtor's income, housing or other expenses are so high that it would be an abuse of the provisions of Ch. 7 relief. Instead, it is akin to "you'll know it when you see it." Court dismissed this case in which debtors had income of more than \$270,000, live in an \$800,000 house, maintain three car payments, as well as payments on tractors, mowers, all-terrain vehicles, and a time share.

#### **- Craig & Mary Short, Case No. 08-80155**

- Court dismissed case where debtors have income of more than \$148,000 per year, who are spending over \$3,500 per month on a home mortgage and over \$1,800 a month to lease or purchase 2 vehicles.

- BUT, in **Christina Newman, Case No. 07-82502** Court denied motion to dismiss in which debtor had mortgage payment of \$4,500 for \$500,000 house. Court noted bankruptcy was precipitated by a job loss and non-debtor spouse was covering most of expenses for house payment.

- UST says that to calculate what your monthly payment should be as it relates to your car payment, you should divide the remaining balance owed and divide that by 60 months and that should be your monthly payment. It is basically like refinancing.

## **16. Chapter 13 Issues**

- a. Disposable Income and Line 54 - Elimination of Child Support Payments, Foster Care

Payments and Disability Payments for Dependent Child from consideration of disposable income. 11 U.S.C. Section 1325(b)(2).

b. Disposable Income & Line 55 - Qualified Retirement Deductions Eliminated from disposable income including contributions and loan repayments. 11 U.S.C. Sections 362(b)(19), 541(b)(7) and Section 1322(f).

c. What to remember in converted cases is:

- Calculation of Current Monthly Income - 11 U.S.C. 101 (10A)
- Whether debtor must always file a form B22A
- Changed circumstances
- Declination

- six month income doesn't change when converting to a Ch. 13. It will be considered a "special circumstance" if it is shown that income has changed.

- UST does not need an amended Means Test Form when converting to a Ch. 7.

- UST would prefer that debtors file an amended Schedule I and Schedule J if income has changed.

**Question:** Will debtors be able to use the internet expense on line 32?

**Answer:** Yes.

**Question:** There is a catch 22 between forms 22a and 22c. What if a case is forced from a Chapter 7 to a Chapter 13 and the debtors are not able to fund a plan?

**Answer:** Can't prejudge a Ch. 13. There are a variety of things that could come up in a Ch. 13 that in a Ch. 7. UST has to look at it, when it is a Ch. 7 case, and a motion to dismiss is filed, UST solely looks at it under Ch. 7 rules. Can't consider "what if" it goes to Ch. 13. Can it fund a plan.

### **New U.S. Trustee Initiative - Creditor Abuse**

- UST will prosecute actions against debtors, bankruptcy petition preparers, malfeasant counsel, and creditors who abuse the system.

#### **- Focus of Initiative is Mortgage Servicing Abuses**

a. Mortgage servicing abuse occurs when a servicer obtains or attempts to obtain unwarranted fees or other costs from borrowers, engages in unfair collection practices, or through its own improper behavior or inaction causes borrowers to be more likely to go into default or have their homes foreclosed.

b. For example, if creditor is stating that debtors owe more than what they do and the debtors can prove it, notify the UST immediately. Also notify UST if the creditor is charging

excessive fees etc.

**- Possible Mortgage Servicing Abuses - False or Inaccurate Claims**

- a. Issues with proper claims calculations, fees and expenses, and application of plan payments.
- b. Overstatement of arrearages for cure.
- c. Excessive/unwarranted fees, for example, excessive inspection fees, unreasonable appraisals, document generation fees, bankruptcy servicing fees, “bankruptcy status” fees.

- Mortgage holder is allowed to charge fees but cannot be unreasonable.

**- Possible Mortgage Servicing Abuses - Violation of Automatic Stay/Discharge Injunction**

- a. Attempts to collect discharged debts, fees and charges
- b. Misapplication of ch. 13 plan payments. Trustee will have to track these payments manually.

**SECTION 524(I) (New provision)**

- Section 524(I) of the Bankruptcy Code now states as follows: “The willful failure of a creditor to credit payments received under a plan confirmed under this title, unless the order confirming the plan is revoked, the plan is in default, or the creditor has not received payments required to be made under the plan in the manner required by the plan (including crediting the amounts required under the plan), shall constitute a violation of an injunction under subsection (a)(2) [the discharge] if the act of the creditor to collect and failure to credit payments in the manner required by the plan caused material injury to the debtor.”

- This allows the debtor to have a cause of action against the creditor if the credit did not credit the payments as stated in the plan (as long as the plan has been confirmed). Also, the debtor can claim damages from the creditor if so proven.

- Section 524(I) requires lenders to credit payments received during Ch. 13 bankruptcies as expressly provided in the bankruptcy plan. Although before BAPCPA, long-term debts under Ch. 13 were excepted from discharge violation cases against lenders that hold or service long-term debt.

**- Other possible Consumer Creditor Abuses**

- \_\_\_\_\_ a. False or inaccurate claims
- b. Improperly including PII (identifiable information) on Claims
- c. Improper solicitation for extension of credit
- d. Reaffirmation Agreement abuses

**- False or Inaccurate Claims I - Claim filed on discharge debts**

- a. Bankruptcy case #1 (Ch. 7) - Debt discharged
- b. Bankruptcy case #2 (Ch. 13) - POC filed for discharged debt from the Ch. 7

- Example, when a creditor files a POC in a new BK that has been filed by the debtors but said debt was already discharged in previous BK filed by the debtors. This tends to happen with the debt has been transferred to other creditors.

- Creditors computer system does not properly identify prior bankruptcy case.
- Receivables assigned in bulk without identification of enforceable claims, and the assignee does not conduct an adequate investigation.

**- False or Inaccurate Claims II- Wrong Debtor**

\_\_\_\_\_ a. Collection agencies filing POC's with credit card records for person different than the debtor.

**- False or Inaccurate Claims III- Inadequate documentation in bulk assignments**

\_\_\_\_\_ a. Assignee does not attach supporting documents  
\_\_\_\_\_ b. Pursuant to Fed. R. Bankr. P. 3001, such a claim not entitled to prima facie validity  
\_\_\_\_\_ c. Creditor and attorney filing claim subject to sanctions under Fed. R. Bankr. P. 9011.  
See in re Wingerter, 376 B.R. 221 (Bankr. N.D. Ohio 2007).

**- Improperly including PII (personal identification information) on Claim**

\_\_\_\_\_ a. Creditor files claim with debtor PII included  
\_\_\_\_\_ b. Rule 9037 requires that documents filed by parties (including proof of claims) be redacted to delete certain personal information - including the first five digits of the debtor's SSN.

**- Improper solicitation for extension of credit**

\_\_\_\_\_ a. Post petition solicitation of consumers to apply for credit  
\_\_\_\_\_ b. May appear as official looking government document, ie.. Use of the Great Seal of the United States, use of words such as "United States Bankruptcy Court:, Use of words such as "Office of Chapter 13 Trustee."

**- Reaffirmation Agreements abuses by creditors**

\_\_\_\_\_ a. Section 524: Routine oversight of pro se reaffirmation agreements is assigned to the court.  
\_\_\_\_\_ b. Required disclosures and oversight should curb abuses that are apparent on their face.  
\_\_\_\_\_ c. Addition of unreasonable attorney's fees and costs.

- d. 523 threats
- e. Policy by creditor to not file reaffirmation agreements. **In re Latanowich**, 207 B.R. 326 (Bankr.D.Mass.1997); **Conley v. Sears Roebuck & Co.**, 222 B.R. 181 (D.Mass.1998).